

May 19, 1999

LETTER 1278

MARKET ACTION: Important: Please read the Investment Position section of this Letter first. Then continue below.

On April 20 my Primary Trend Index pushed up through its 89-day moving average, moving into a bullish mode. Since then the market has moved strongly higher. Furthermore, the advance-decline ratio, which up to mid-March had been acting poorly, began to improve, starting the week May 13. It's clear that **money has been spreading out** to the medium-size and secondary companies. In other words, the A-D ratio, having behaved negatively for over a year, is now pushing up, following the lead of the big-cap stocks. So rather than pulling the big-cap stock averages down, the lagging breadth headed higher, following the much stronger lead of the blue-chip stocks. This is extremely **rare action** – but don't argue with it, it's what's happening.

Despite the improvement in breadth, the stock market is still dramatically split. Just how split the stock market is can be seen in these two sets of statistics. The NYSE advance-decline ratio topped out on April 3, 1998. The Russell 2000 topped out on April 20, 1998. The Value Line (unweighted) average topped out on April 21, 1998. The D-J Utility Average topped out on October 9, 1998. That's one group.

Then we have a second group, which consists of the popular averages. The Nasdaq Composite, the S&P 500, the NYSE Composite and the Dow all hit highs during April-May 1999.

Obviously, any of the above indices and averages could still advance to new highs. But the split is obvious, and it highlights the unorthodox action that has been characteristic of this market for over a year.

The intra-day action continues to be erratic. In our office we say – prices, particularly prices at the opening, mean nothing, and the action during most sessions is either confusing or meaningless – **until the final hour**. The Dow can be up 100 points, down 100 points; it doesn't much matter until the final hour and often until the last 30 minutes. That's how skittish and volatile this market is. So when someone asks me, "How's the market?" I tell them, "Call me five minutes before the close, and hopefully, I'll be able to tell you." **Comment:** The bond futures close an hour before the stock market closes, and it seems that traders wait – and if the bonds don't close down sharply, the traders will jump in and buy the S&P futures.

The statistic I hear is that 25% of the US population is now "wired," meaning that they are on the Internet. I'm doing a little better than that, because 43% of my subscribers are now on the net. I wish it was 60% or 90% but it isn't. The reason I'm so insistent about getting my subscribers on the net is that the net gives you access to my web site, and the web site gives you access to my daily analysis.

Right now, I feel the market is at a very important juncture. The feeling, the mind-set, that I detect is that nothing can stop the market's upside progress. Of course, this is another way of saying that "trees can grow to the sky." Old-timers know that trees can grow awfully high – but they also know that no tree has hit the heavens yet. Market veterans are also aware of another

May 7 DJIA 11031.59; PTI 5365; A-D Ratio +4.23
May 14 DJIA 10913.32; PTI 5371; A-D Ratio +4.09
Dow Yield: 1.48%; Dow Price/Earnings: 27.1
Dow 144-day MA: 9707; Dow 34-day MA: 10615
Dow Times Book Value: 6.84; PTI 89-day MA: 5334
Percentage of Undervalued Blue-chips: 6%
Gold 34-day MA: 283.60

simple market truism – a trend will continue until it reverses.

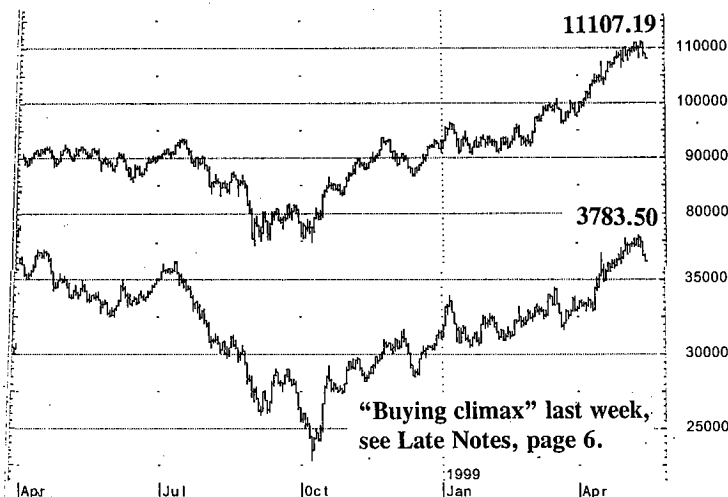
Investors are now literally "assaulted" hourly with an avalanche of news. Which is where my **Primary Trend Index (PTI)** comes in. The PTI reduces all market news and information, all supply and demand, down to a single line. And that line can only do two things – it can go up or it can go down. But the action of the "PTI line" is critical in gauging which way the market is going.

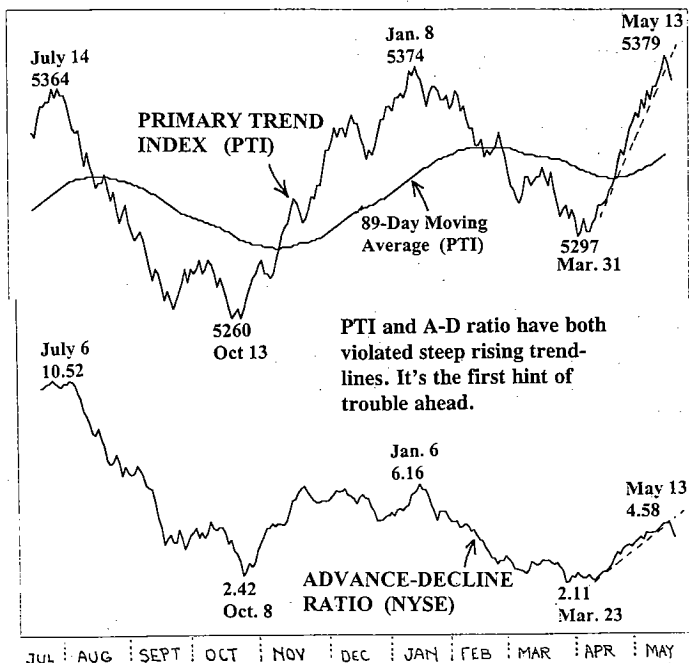
The stock market, in my opinion, has now moved beyond all "normal" measurements of valuation. It has also defied hundreds of methods of analysis. Personally, I believe the market is in "wonderland," but so what. We still have to deal with it.

Therefore, I'm placing particular emphasis on my Primary Trend Index (PTI). As you can see on the page 2 chart, the PTI has been climbing above a rising trendline that extends up from the early-April low. As long as the PTI respects that rising trendline, the market's direction is clear – it's bullish.

If that trendline is violated, the market's direction will become questionable. The next step – if the PTI then continues down, and it breaks below its 89-day moving average (which now stands at 5331), the market trend will have turned bearish. I can't make it any clearer or simpler than that. So why guess, why try to outsmart the market, I'm going to let the PTI tell the story. And it will tell the story.

So it follows that if you are on my web site every day, you have an advantage. The advantage is that you'll have a daily up-date. Which is why I keep "bugging" my subscribers to do whatever it takes -- but **get on the Internet**.





I've talked before about my **Big Money Breadth Index (BBI)**. The BBI is an advance-decline line of the 10 largest-cap stocks in the S&P. What these 10 biggest-cap stocks do is obviously extremely important. The action of the BBI during 1999 has been strange. It's been strange because despite new highs in the major stock averages, the high for the BBI was recorded last December at 1088. The low for the BBI was recorded this year on March 3 at 1037. The BBI, so far, in 1999, has been unable to better its December high. Four times it has come down to test the 1037-1038 level. Each time the BBI has touched the 1037-1038 level, it has rallied the following day. I believe it will be very important to see whether the BBI can break out above 1088 or whether it will break down below 1037.

Just to remind my subscribers, most of what you read in the newspapers is **history**. Most individual stock stories and write-ups are **history**. All economic data and statistics are **history**. But the **market is not interested in history**. The function of the market is to discount, to look ahead. Which is why I spend so much time examining, studying and writing about the **action of the stock market itself**. The secret of our economic future lies in a correct analysis of the action of the stock market. It's therefore ironic that I know of nothing more difficult than a correct interpretation of stock market action.

One reason why stock market analysis is so difficult is that analysis is not a mechanical function. A large part of stock market analysis is art. And art varies with the ability and intuition and the knowledge of the individual analyst.

A bit more on valuations: This market has upset any of the measures of valuation that I've ever dealt with. For instance, the earnings yield for the S&P 500 is now 2.80. I'm not talking about the dividend yield, I'm talking about earnings divided by price - the earnings yield. Against that, the yield on the 10-year treasury note is 5.66%. The yield on the notes (actual cash coming in the form of interest that is free of state taxes) is almost twice that of the earnings yield on the S&P. In other words, even if earnings doubled on the S&P Composite, it would just about equal the actual interest on the T-notes.

As for dividends, the dividend yield on the S&P is now 1.2%. The yield on the 30-year Treasury bond is now 5.9%. This means that the bond yield is 4.9 times the yield on the S&P. This is the highest ratio I've ever seen. Valuation insanity? In my opinion, you're looking at it.

Question: Russell, what do you think is the weakest link in the stock market chain?

Answer: I believe it is the over-extended and, in my opinion, very vulnerable consumer. Consumers have been spending almost all their income (zero or even negative savings) in one of the wildest buying binges in US history. Furthermore, Americans are using paper gains in stocks and mutual funds as a proxy for savings. At some point, the consumer will exhaust his or her buying proclivities and pull back on spending or some incident will come along which will frighten him or her into cutting back. When that happens, corporate profits will contract and the economy will be facing trouble in the form of a recession.

Question: Russell, what would it take to turn you out and out bullish?

Answer: Again, I'll remind subscribers that the very basis of Dow Theory is **values**. This market is sporting the most over-valued stocks in Wall Street history. Therefore, turning bullish here, advocating buying over-valued stocks here, would go against everything I've ever learned about the Dow Theory (see Investment Position).

Actually, on the basis of historical comparisons, the best buy right now would be debt, probably government debt. If I can get 5.66% (free of state taxes) from a 10-year T-note, how can I buy a collection of stocks paying dividends of 1.2% and in most cases even less? "But those stocks may go higher," is the response. And my response is, "Right, and they may go lower too, so why should I shoot crap when I can get a guaranteed rate of return of 5.66%?"

Question: Russell, do you mean to tell me that I have to wait for a bear market bottom to buy stocks? That could take a few years, maybe more.

Answer: Look, the markets don't arrange themselves for your convenience or my convenience. Just because you have money to spend doesn't mean that stocks are a buy. Ironically, when the market appears most inviting, it's usually the worst time to buy. And when the market looks most forbidding, at a bear market bottom, that's usually the best time to buy.

Question: OK Russell, so what are you doing with your own money at present?

Answer: Right now I'm compounding my money in Treasury debt and a few high-yielding preferred stocks. My main concern at this time is to **avoid losing money in the market**. I look at the situation this way: (1) Stocks are grossly over-valued based on all historical measurements; (2) dividend yields, a time-honored measurement of value, are almost non-existent; (3) the Dow has not closed below the low of a preceding year since 1982 (the longer this amazing series goes on, the nearer we are to the end of the series); (4) the big averages have enjoyed huge percentage increases for three years in a row, but can a fourth be in the card? (5) the public is in a state of euphoria regarding the stock market. Euphorias don't end well; (6) based on everything I've learned in half a century of studying the markets, this is a time to be highly defensive; and (7) the odds are fairly high that at current prices the stock market has **already discounted** the best that lies ahead - or at least, the market is very close to that situation.

What the informed investor needs now is **perspective and patience**. One needs perspective in order to see where the market is in the light of history. One needs patience so that she can wait for the great buying opportunities that lie ahead.

RISK: In the huge advance of the averages this year, one concept has been banished, forgotten, buried. That concept is

risk. It has been said that the key to successful investing is an understanding of risk.

Old-timers who have lived through hard times, severe corrections, bear markets, understand the importance of risk. They know the importance of risk because they have seen what can happen when a portfolio is not set up to handle risk.

Stocks can do anything, they can go up, they can go down, they can stay down, they can go broke. Mutual funds can go down, they can stay down, but they can't go broke (although hedge funds can go through bankruptcy).

Government bills, notes and bonds can fluctuate, they can fluctuate broadly at times, but they enjoy the full faith and credit of the US government and they always pay off at maturity. Therefore, the only risk entailed in buying government paper is that the paper can pay off in depreciated dollars. How about the risk of fluctuations as well as depreciation of the currency? You can eliminate as much of both as you want by buying short maturities. But the guarantee is there -- you will get your money back. There is no such guarantee when you buy a stock. There's a risk involved.

And that's the problem with the current market. In its high-priced, dividend-less current state, there's almost no allowance for risk. Back in 1974 I bought both Exxon and Texaco at a time when they both yielded 10%. That was a frightening time, but I measured the risk as follows. These are great companies with good earnings even though the stocks have been battered. At a yield of 10% based on well-protected dividends, if the stocks decline I will collect 10% the first year, 20% in two years or 30% in three years. So let the stocks decline, the fat dividends will protect me to a large extent. It seemed to me, even in those panic-prone times, that these two stocks were as near riskless as anything I could find. I was protected by fat, well-covered dividends.

Now compare that period and those values with what's offered today. Today you are buying or holding stocks after a record 8 1/2 years of economic expansion, at a time when the public is extremely bullish, at a time when the dividend yield on stocks is at its lowest level in stock market history.

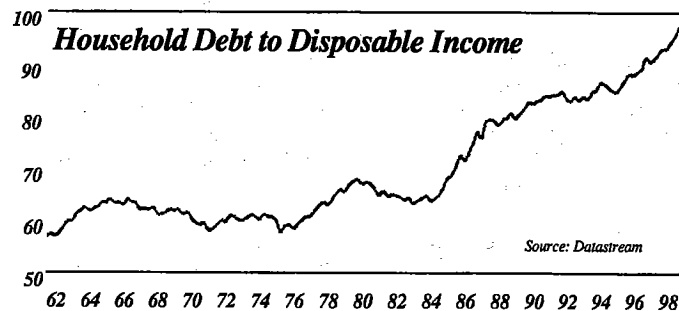
So question - how would your risk exposure look if the market began to head down? How would you feel sitting with a portfolio of assorted stocks paying 1% on average? And what protection would you have if a bear market started? How would you feel holding stocks that were declining, stocks that were yielding 1%, rather than holding 10-year government notes paying 5.66%?

Of course, in today's euphoric market no one (or almost no one) is thinking in terms of a major (or, it seems, even a minor) market decline. The public is convinced that Wall Street is a one-way street and the "one way" is toward perpetually higher prices.

I'm often asked the question, "Just how bullish are investors today compared, for instance, with euphoric periods of the past?" Peter Eliades has an interesting test and a very ingenious answer. Peter takes into account all 100-month periods in stock market history. Then he computes **how many times** the Dow was up over its previous month in any 100-month period. The record is fascinating. Through 1998, the greatest number of up-months out of any 100 months was 69. But in January of 1999 for the first time in history there were 70 up-months out of the last 100 months. Even more incredible, since January the 70 up-months out of 100 has held in each month including April. Peter's conclusion (and I agree) is that the period from January 1999 to the present has been the period of the most extreme bullishness in the stock market history.

Another significant test of bullishness is how far consumers are willing to go into debt. This chart shows that average household

debt is now almost equal to total disposable income. At the same time, consumers have run down their savings into the negative column. They are now spending more than they are taking in. To counter that thesis, some economists are insisting the paper profits in the stock market should be considered savings. I disagree. I consider savings to be liquid assets that can't be wiped out by a stock market decline or a recession.



INVESTMENT POSITION: With both the Dow and the Transports both having advanced to new record highs, should I take the bear out of the box? Should I leave him in? What's the correct thing to do? **With both D-J Averages hitting new highs, under Dow Theory, I have no choice but to put the bull back in the box.**



"Reluctant little bull"

Does that mean it's time to buy? Do joint new highs constitute a buy signal? **Absolutely not with these values**, and remember, the essence of Dow Theory is a consideration of values. And what about the Dow Theory bear signal of August 4, 1998? Was that a false signal? Or was it just telling us that we had an abbreviated bear market that ended in March of this year? Or was it a bear market signal which pertained to the majority of stocks but not to the major stock averages (that would be unprecedented). Or again, was I just plain mistaken in interpreting the August 4 action as a bear signal?

Frankly, I don't have the answer. I know that following the August 4 "bear signal" most stocks declined substantially, and that as this is written the majority of stocks have not recovered anywhere near their 1998-99 losses.

Nevertheless, I can't call this a bear market with the two Dow Averages having just hit record highs. Therefore, I've reluctantly put the bull back in the box. I don't like this bull. I don't trust this bull. Remember, in every bull market there's a confirmation that represents the final one, **the last one prior to the next bear market. Last week's confirmation could be it.**

What about the predictive value of the last week's belated Transport confirmation? I'll stick to what I've said all long - because the Transport confirmation came one year **too late**, I give it **no predictive value** (as a rule, the closer together in time a confirmation, the more important a confirmation for predictive purposes).

What to do? I told you earlier what I'm doing. I'm buying Treasury notes and compounding. I have never bought stocks simply because they're rising. I won't do that, I wouldn't tell me kids to do that, and I won't tell my subscribers to do that.

As of now, the advance-decline ratio (a proxy for all the stocks on the NYSE) has recovered only 19% of its April 1998 to March 1999 losses. With the Dow Averages at record highs last week, that's very strange action. It's too strange for me. I'm continuing to play it safe. You should too.

NOTES & QUOTES: This e-mail came in last week, and it's typical: "Thank you so much for the daily comments on your web site. I don't know how many times I've received your Letter, and in the day or so since you mailed it the market has done something unusual in the interim (in fact, it's happened almost every time lately!). And I wonder what comment you might have. Now I know! The daily writings are a tremendous innovation and I can't wait to read them every day at 1:30. Keep up the good work. B.H. Beaverton, Oregon." **Russell Comment:** I'm now getting about 20 e-mails a day, and sadly, I just can't answer them all (many ask detailed questions), but they're very helpful, and rest assured I read each one carefully and I certainly appreciate them.

Items: Treasury Secretary Rubin has resigned. He's probably tired, or maybe he's exhausted from frustration at not being at Goldman Sachs when the big pay-off arrived. . . **Bonds** - they were whacked last week, are now over-sold, and should hold for a while. . . **Kosovo** - Time magazine calls it "Albright's War." Funny, I thought it was Clinton's war. *USA Today* headlines: "Communing to War. Pilots drop bombs, then go home to loved ones." *The Christian Science Monitor* writes "A reminder that Kosovo bombing is not a video game." Meanwhile, misdirected NATO bombs keep falling on the wrong targets. And I get the feeling that there's something really stupid about all this endless bombing of various countries. Did Clinton's mom forbid him to play with firecrackers? . . . **Utilities**; the D-J Utility Average is within a few points of its record high. The Utility industry is now deregulated and many utility companies are diversifying into all sorts of endeavors. Utilities are the only stocks I would even consider here - NSP, AEP, TXU, SO, FPC, - all pay 5% or better.

Now that Goldman Sachs is a real live tradable stock, how about a good rumor? OK, here's one. Goldman might buy E*Trade. Goldman, by far the biggest underwriter of Internet stocks, is obviously interested in representation on the net. According to "sources," in '97 Goldman wanted to buy Schwab, but decided against it because the price for Schwab was considered too high.

Congress is chaffing because Clinton started a war without Congressional approval. Officially, of course, the war in Yugoslavia is not a war. After more the 4,000 bomb runs, 1.5 million displaced people, and seven weeks of reported killings and burnings, Washington still calls it a "conflict." By calling the war anything but a war, the Clinton White House can avoid the inconvenient fact that only the US Congress can declare war. The word "war" is avoided because war implies expensive, large-scale conflict with casualties. Furthermore, a real, declared war would anger the Russians, who are friends of the Serbs. Facts: Since its founding, the US has used military force overseas more than 200 times. But the US has declared war only five times: the War of 1812, the Mexican-American War, the Spanish-American War, World War I and World War II.

A subscriber asks via e-mail: "When and if this market starts down big, where will all the money go? I have read your comments about the Fed trying to create enough money to balance the deflation that appears to be going on worldwide. Where would all the money go if there is a decline of 30%, 40%, 50%. Gold? Bonds? Mattresses? J.W.F." **Russell Answer:** When stocks head down the money evaporates, it goes into thin air. When you buy a new car for \$40,000 and six months later you try to sell it and you are offered \$32,000, where does that \$8,000 go? A bear market is not a zero-sum game. In a bear market the money doesn't transfer to some place else, it disappears into thin air in the form of capital losses. In a big bear market, trillions of dollars of value are lost as stock prices (and often the price of everything else) heads south.

What's this? It seems that investors are now buying anything else but funds. Since most of the funds haven't been able to keep up with the Dow or the S&P, investors want to go where the money

is. The money has been in individual hot stocks. Net sales of domestic stock funds, mutual fund companies most profitable product, totaled \$32.1 billion during the first quarter, a major 45% drop from the quarter a year earlier. That's on top of a 24% drop in net equity sales for all of 1998, according to Financial Research Corp. of Boston. This has hit the fund groups. Nearly half the 636 mutual fund companies saw overall net redemptions during the first quarter vs. 26% in the first quarter of last year. Net sales of stock and bond funds during the first quarter totaled \$41.2 billion, a huge 51% drop from 1998's first quarter, mainly due to the drop in stock fund sales. The hot area of funds has been the index funds. Vanguard group, which has the leading index fund, saw their sales rise 18% in the first quarter.

I keep getting questions about Y2K. I wish I had the final answer. I don't. Evidently, most of America's large corporations and hopefully, a lot (but definitely not all) of the smaller outfits will be ready. But overseas suppliers, that's a different story. I just received a letter from a subscriber, a professor from the University of Nairobi in Kenya, East Africa. The good professor writes, "We are probably several years away from the benefits you enjoy in La Jolla, and by the time Y2K hits us whole chunks of planet Earth, particularly the African countries, will suffer far more than you will. Frankly, they've only begun to talk about Y2K here in the last few months, and Kenya will not be 'ready' before the millennium." **Russell Comment:** That should give you an idea of what we could be in for when Y2K hits.

One of the more interesting net stocks is Priceline.com, the outfit that allows you to name your own price for items (of course, the hotel or airline or whatever doesn't have to accept your bid, but it's a novel idea and seems to be working). The company is only two years old and is already valued at billions. Its backers are big names: the company is led by Richard Braddock, former Time Warner co-chairman. Then there's Nicholas J. Nicholas and third is Marshall Loeb, former top editor of *Fortune* and *Money*. Morgan Stanley Dean Witter underwrote the stock, which went public on March 31. The offering created an immediate \$12 billion market cap, of which Mr. Braddock got \$1.2 billion (oops, he owns restricted stock that he can't sell for a year). Nicholas got \$324 million and poor Mr. Loeb got only \$2.8 million. By the way, the *New York Observer* keeps track of the Internet stocks via what it calls its Internet Sucker Index. Their net index recently stood at \$449 billion, about 20% of the value of the whole D-J Industrial Average. Is this a great stock market or what!!!

TheStreet.com stock was priced at 19, but the market immediately bid the stock up to 71 and it closed at 60. The company had revenue of roughly \$4 million last year with losses of \$16 million. The market now values the stock at \$1.5 billion. In comparison, the New York Times is valued at \$6 billion and Dow Jones is valued at \$5 billion. Jim Cramer, the wild man and principal who appears in almost every avenue of communications from CNBC to the *New York Observer* is now a multimillionaire (worth over \$200 million); the principals of theStreet.com pulled in about \$700 million for themselves. How will theStreet.com make money? Darned if I know. They'll be selling market info, but there's a ton of info for free on the net. There's so much free info I don't know what to do with it all. For instance, all you web users, try *DailyStocks.com*! As for the Dow Theory web site, I give my own analysis and my own opinions and it's gratis for subscribers. Frankly, I don't know what to do with 95% of the stock info I can get on the net.

How hot are the IPOs? E*Trade, the number 3 on-line brokerage outfit, evidently ran ads that convinced some traders that they could obtain access to IPOs by opening E*Trade accounts. That allegedly ran against California law. At any rate, a class-action suit in State Superior Court, LA, has it that even if an E*Trade customer indicates an interest in a new IPO through an on-line bulletin board, the offering is either not available or not available in any meaningful amount. Will the class action suit win, and will the complainant receive restitution? Who knows,

who cares – all I know is that if I want to buy 1,000 shares of a hot new IPO, there's no way I'm going to get those shares. But I'm not angry, and I'm not going to sue.

Anyone who's ever been near death and survived probably knows the feeling of "Hey, I feel great, I feel blessed, I'm alive." I know that feeling, having survived combat in WW II, a near-fatal mastoid operation at age 8, a high-speed motorcycle crash, two heart attacks, a quintuple by-pass, being mugged twice at knife point (once in NYC and once in San Francisco) and er. two divorces. They say that whatever doesn't kill you makes you stronger. Call me Hercules. What I'm saying is "Enjoy the fact that you are alive, it only happens once (unless you believe in reincarnation)." What made me write this? Two items that both appeared in the May 5th paper. Ah, life can be fleeting. And death can come in many strange and unexpected ways.

EL VERGEL, Spain — Tigers fatally mauled an elderly German couple yesterday at a game park in eastern Spain.

The Germans ignored posted warnings in several languages, including German, saying they were in a dangerous area and should remain in their car with the windows rolled up, said an employee at the Safari El Vergel.

They got out of their car, and three tigers pounced on them, inflicting fatal neck wounds, state radio said.

BANGKOK, Thailand — A Thai snake charmer's luck ran out Monday when a python he captured from a neighbor's home coiled itself around his neck and strangled him.

Hie Kerdchochuay, 55, who was known for his skills at catching and charming snakes, put the reptile in a sack and was walking home when villagers asked to see the python.

Hie took the snake out and put it around his neck, then screamed for help when the reptile wrapped itself tightly around his neck and did not let go until Hie fell dead, police said.

I love the Internet, but I love newspapers just as much. Sadly, circulation in the newspaper business nationwide is declining. The latest figures from the Audit Bureau of Circulation showed average daily circulation down 0.5%, while Sunday circulation was down 1% for the six months ending March 31. The nationals bucked the trend. Average daily circulation of *USA Today* reached 1.8 million, making it the best-selling newspaper in the nation on average - although *The Wall Street Journal* outsells it on a Monday through Thursday basis (*USA Today's* Friday circulation is huge). *The New York Times'* Sunday edition sells 1.6 million papers, up 2.3%. **Russell Opinion:** *The Sunday NY Times* is a great paper – there's nothing even close. What's hurting the newspapers? It's TV. Up until the 1990s circulation wasn't growing. Now circulation (despite a rising population) is actually declining. And now a new worry – the Internet.

Speaking of the net, a new phenomenon called "streaming" is coming. It's a technology that promises to make the cable industry's dream of 500 channels come true. With streaming video a viewer can delve into huge databases and bring up video programs with a mouse click, just like bringing up a web site. This can expand the number of "TV" channels into theoretical infinity. The hottest new streaming video company is Broadcast.com, which was sold to Yahoo for \$5.7 billion. You want to see "Frankenstein" at 4PM this afternoon? A few clicks of your mouse and you are there (there being a three foot by four foot flat screen that you've hung on your living room wall).

AOL will compete directly with MSFT by delivering the Internet over TV sets. MSFT already does that via WebTV, which has about 800,000 users. The high for AOL was 175, and I remain skeptical about this stock. Who needs it to get on the net, and what else does it offer besides chat rooms?

Sell Your Future: James Brown, 67-year-old "Godfather of Soul," has a deal with the Pullman Group to create \$100 million of bonds backed by the singer's song and music publishing royalties. The deal, which closed last week, will earn Brown a \$35-55 million payday. The last time this kind of deal occurred

was three years ago when David Bowie sold \$55 million of bonds backed by Bowie's future royalties. Let the good times roll.

GE's chairman told CNBC (May 7) that in 1980, 85% of GE's sales were in manufacturing and 15% in finance and service. Today 75% of its revenue is in finance and service and only 25% is in manufacturing. On the same day, the Labor Dept. announced that since the start of the global financial crisis the US has lost 400,000 jobs in manufacturing. **Russell Comment:** The way it's going, soon nothing will be manufactured in the US and we'll be existing totally on revenue from entertainment and communication. Even "made in the USA" labels will be made overseas.

Speaking of communications, many New York restaurants are banning people from the obnoxious practice of talking at the table on their cell phones. Equally obnoxious, and you see it quite often, is men seated at the table with their hats on. My dad, a southerner, taught me (1) take your hat off when you enter a house or a restaurant, (2) stand up when someone comes to your table, (3) give a woman your seat on the subway or a bus, (4) address an older person as sir or m'am. (5) say thank you for any service, no matter how small. That's what it was like in "the old days." Recite these five to a kid today, and he wouldn't know what you were talking about.

The monster merger between AT&T and MediaOne is on. T is going to pay \$4,600 for each of MediaOne's 5 million customers in its \$55.5 billion deal. This will put T in 60 million US homes. The new T deal will offer subscribers "everything." Here's how Merrill Lynch thinks your monthly bill will look. \$44 for basic cable, plus \$12 for premium channels, plus \$16 for digital channels, plus \$35 for Internet access, plus \$70 for phone service. Gad, that adds up to \$177 per month. Will you and I pay it? We'll see. But then there's the competition. Phone companies are starting to provide their own high-speed Internet services. And satellite companies will be hawking their newly won right to offer local TV stations (I have a satellite, and to get local stations I have to have the cable plus the satellite). In all, it promises to be one humongous battle for the consumers' money, and the question is – who will make the profits and how good will the profits be? Of course, Microsoft wants to be in it for the goodies, so it has invested \$5 billion in AT&T, and that literally guarantees that T will be buying a lot of MSFT software for its boxes (MSFT's chief competition here is Sun Microsystems, which also makes the software).

It looks as though there's going to be a **single European stock market**. Last week London and Frankfurt agreed to bilateral talks with six other exchanges. The Amsterdam, Brussels, Madrid, Milan, Paris and Zurich stock exchanges signed a memorandum of understanding with London and Frankfurt to join the pan-European venture. Consolidation, it's the name of the game today. And no, Dow Theory Letters is not joining any group or association or combine – I'm going to be the last individual enterprise in the nation.

Y2K again. Bob Bennett, Chairman of the Senate's Special Committee on the Year 2000 Technology Problem compares the Year 2000 computer bug to the biblical Tower of Babel, saying a breakdown in the common language could cause chaos. "The world speaks a common language called digital code," said Bennett (R-Utah). "If the connection is broken, we're back to the Tower of Babel, where we cannot talk to each other. We can't trade securities, we can't change currency, we can't exchange information. Everything shuts down." People ask me if we're going to be all right. Says Bennett, "That depends on what 'all right' means." **Russell Comment:** What does it mean? Nobody, including Bennett, seems to know.

A new book recommended by the *WSJ* (May 10) is entitled "Getting Rich in America" (Dwight Lee and Richard McKenzie). Their first rule: "Think of America as a land of

choices." Yeah, we knew that. Their second rule: "Take seriously the power of compound interest." I've been promoting the compound interest thesis ever since I started writing *Dow Theory Letters*. Compounding is the only sure way of getting rich, but, of course, you need time and discipline (see "Rich Man, Poor Man" on my web site).

The NFL is drooling to get a team into LA, the nation's second largest market. But Los Angelenos couldn't be less interested. What LA is interested in is - soccer. When Mexico faced Argentina in soccer, the Coliseum's 92,000 seats were sold out. Writes the *LA Times*, "If this was an electoral referendum, soccer would be winning by a landslide. Soccer has quietly conquered LA, a testimony to the way Latin American immigration is reshaping California, where a third of the nation's estimated 30 million Latinos reside. There are three things that unite the Hispanic community, their flag, their religion and soccer."

Is it possible, Microsoft is already a dinosaur? That's what John Browning and Spencer Reiss (Op-Ed, *WSJ* May 16) think. They write, "Microsoft's \$5 billion investment in AT&T is an admission of weakness, if not outright defeat." After all, if you've got the hot product, the product that is "the answer," why would you have to pay \$5 billion to insure that your software is going to be used by AT&T? The two add, "If we've learned anything from the Internet's explosive growth, it's that open systems are the breeding ground of success. Microsoft and AT&T are re-creating the Big Blue (IBM) monolith that Microsoft defeated - closed, inward-looking, vertically integrated. The question is - who will be their Microsoft?"

GOLD: Just when it looked as though gold was moving up and gaining some momentum, along comes the UK's central bank saying that they're going to sell 415 tons of gold or 15% of its entire holdings over the next few years. Now why would they announce the sale? If I'm going to sell any item, I want to get the best price possible, so the last thing I'm going to do is announce my forthcoming sale. Is there a plan (gold-philes call it a "conspiracy") to keep the price of gold down? Well, I don't think it's a conspiracy; more likely it's just the central bankers believing that they can control the value of their paper currencies and mask inflation by selling or threatening to sell gold. And, of course, gold is the enemy, because you can bankrupt a paper currency, you can manipulate a paper currency, you can do a lot of things with a paper currency - but gold, gold is real, indestructible money, and if a nation's paper currency is in trouble, it always requires more of its depreciating paper to buy an ounce of that darn gold.

So the Swiss want to sell gold, the IMF wants to sell gold, the UK wants to sell gold, and pretty soon most of the world's gold will be back in private hands. At that point the central banks will have lost their power to drive gold down - and then what? By that time I expect the world's paper currencies to do what they've always done (over time), and that is **deteriorate**. Then, with gold largely out of the hands of the central banks, gold will head higher.

Will the central banks sell all their gold? No, they'll be afraid to go that far. So the drama goes on - the central banks vs. real money. In the end, gold will win. Reality always wins over fantasy, and paper money is ultimately a fantasy created in the minds and the printing presses of men.

This daily chart of the Phila. Gold/Silver average pretty well tells the story. Back in October of last year XAU rallied over 85. Next came trouble and over the following six months XAU declined to a final low close on March 30, 1999, of 56.43. From there a nice rally advanced XAU to a high of 82.62 on May 6. Then came the announcement of the UK gold sale. XAU smashed down to close at 67.33 on May 10. Note, however, that

on that decline XAU held in the vicinity of both its 34-day and 144-day moving averages.

Actually, this is not terrible action, but it would be very constructive if XAU held above 67, consolidated, and started to inch up again. The action of XAU is fairly typical of what the gold stocks have done over the past six months or so. So far, not that encouraging, but all is not lost either.



LATE NOTES: Friday, May 14 -- The PTI and the A-D ratio both violated steep rising trendlines. These twin violations reversed the trend of the market from bullish to questionable.

Friday also saw a "buying climax." A buying climax comes when an average (in this case both the Dow and the S&P) hit new highs -- but the average then **closes down for the week** (which both did). A buying climax indicates upside exhaustion plus powerful distribution. It also suggests a reversal in trend.

The **A-D ratio**, from its March 23 low to its May 13 high, tacked on a total of only 2.47 points. Friday's (May 14) drop of .49 points in the A-D ratio erased 20% of the entire March to May advance. The A-D ratio goes up grudgingly but it declines powerfully. The majority of stocks are still under pressure.

It was supposed to be the perpetual "Goldilocks economy" ("not too hot, not too cold, just right") -- consumers continuing to buy their heads off, corporate profits rising far into the new millennium -- plus no inflation as far as the eye could see. But on Friday morning came the news that the Consumer Price Index was up .7% for April, indicating an annualized inflation rate of over 8%. A mistake, a one-shot? Or the inevitable result of a Fed-driven explosion in the money supply?

On the inflation news the bellwether 30-year Treasury bond tanked, plunging over 2 points and pushing the yield to 5.91%. With the yield on the S&P at a miniscule 1.20, the ratio of stock yields to bond interest is now 4.92 in favor of bonds. In other words, S&P dividends would have to more than quadruple to equal the current guaranteed rate (free of state taxes) on bonds. This extraordinary ratio reflects faith by investors in a never-ending rise in corporate earnings with no inflation. In my opinion, the ratio of stock yields to bond interest is now so lopsided that it has reached the point of utter ridiculousness.

The inflationary news produced strange action in gold. On the opening, in the face of the inflationary news, June gold ended the day actually down (!) to 276.2. But many of the gold stocks ignored the weakness in the metal and tacked on fractions. I hesitate to say it, but it does look as though gold is being manipulated. I've long been skeptical of an "anti-gold conspiracy," but I'm beginning to wonder. "We're going to sell our gold, we're going to sell our gold" is the cry of the central banks. Are they actually selling their gold or are they just "going to sell it"? Much as the central banks want it to, gold will not disappear.